477 FILE COPY

Supreme Court, U.S.
FILED
SEP 21 1972
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1972

No. 72-477

EDWARD L. STEPHENSON, GARRICK C. STEPHENSON and THE CENTRAL TRUST COMPANY, as Trustees of Samuel F. Stephenson,

Petitioners,

against

KARL F. LANDEGGER, CARL C. LANDEGGER, GEORGE F. LANDEGGER, PARSONS & WHITTEMORE, INC. and THE BLACK CLAWSON COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ABRAHAM K. WEBER,
Counsel for Petitioners,
70 Pine Street,
New York, New York 10005.

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Statutes and Rules	2
Questions Presented	3
Statement	4
A. The Complaint	5
B. The Trust of February 24, 1969	7
C. Functions of a Stockholder's Derivative Action	8
D. Status to Sue	9
Reasons for Granting the Writ	11
Errors in Affirmance by the Court of Appeals Which Require Correction	12
Conclusion	19
Appendix A—Judgment of Court of Appeals	A1
Appendix B—Opinion of Court of Appeals	A3
Appendix C—Opinion of Judge Charles H. Tenney, U.S.D.J.	A8
Appendix D—Excerpts from amended complaint verified May 18, 1970 and filed May 21, 1970	A15

Table of Authorities

Cases:

	Page
Bolton v. Wernett, 3 A.D. 2d 708	13
Braman v. Westaway, 60 N.Y.S. 2d 190; Sup. Ct. N.Y. Co. 1945	10
Dodge v. Woolsey, 59 U.S. (18 How.) 331	9
Entel v. Guilden, 223 F. Supp. 129; SDNY 1963	11
Foman v. Davis, 371 U.S. 178	14
Geddes v. Anaconda Copper Mining Co., 254 U.S. 590	6
Hardenbergh v. Ray, 151 U.S. 112	13
Hausman v. Bourne, 152 N.Y.S. 2d 667	13
Hawes v. Oakland, 104 U.S. 450	9
Heilbrunn v. Hanover Equities Corporation, 259 F. Supp. 936; SDNY 1966	11
Hoff v. Sprayregan, 52 F.R.D. 243; SDNY 1971	10
Kirby v. American Soda Fountain Co., 194 U.S. 141	13
Lewin v. New York Ambassador, 61 N.Y.S. 2d 492, affd. 271 App. Div. 927 (1947), 67 N.Y.S. 2d 492	10
Magruder v. Drury, 235 U.S. 106	6
Matter of Jones, 306 N.Y. 197	13
Neary v. City Bank Farmers Trust Co., 260 App. Div. 791	13
New York Properties, Inc. v. Neidoff, 10 Misc. 2d 439, 170 N.Y.S. 2d 693; Sup. Ct. N.Y. Co. 1957	10
Pepper v. Litton, 308 U.S. 296	6
Southern Pacific Company v. Bogert, 250 U.S. 483	6
Stewart v. Dunham, 115 U.S. 61	13
Willcox v. Harriman Securities Corporation, 10 F. Supp. 532; SDNY 1933	10

COPY BOUND C

Statutes and Rules: PAGE

Federal Rules of Civil Procedure

Rule 15a 15

Rule 25(a) 2, 3, 14

General Corporation Law, Section 61 10

Book 6, McKinney's Consolidated Laws of New York 9

New York Business Corporation Law

Section 626(a) 3, 9

Section 626(b) 3, 9

Other Authorities:

20 Carmody-Wait Cyclopedia of New York Practice, 2d Ed., pp. 171-172 8

3B Moore's Federal Practice 1969, § 23.1.17, pp. 23.1.152 11

4 Pomeroy on Equity Jurisprudence, 5th Ed., p. 269 9

D CLOSE IN CENTER

IN THE

Supreme Court of the United States

OCTOBER TERM 1972

No.

EDWARD L. STEPHENSON, GARRICK C. STEPHENSON and THE CENTRAL TRUST COMPANY, as Trustees of Samuel F. Stephenson,

Petitioners,

against

KARL F. LANDEGGER, CARL C. LANDEGGER, GEORGE F. LANDEGGER, PARSONS & WHITTEMORE, INC. and THE BLACK CLAWSON COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners, Edward L. Stephenson, Garrick C. Stephenson, and The Central Trust Company, as Trustees of Samuel F. Stephenson ("Petitioners" or "Trustees"), pray that a writ of certiorari issue to review a judgment entered June 26, 1972 in the United States Court of Appeals for the Second Circuit which affirmed an order of the United States District Court for the Southern District of New York.

The underlying action was a stockholder's derivative suit instituted in the District Court (Docket No. 69 Civil 3282) on July 25, 1969 by Samuel F. Stephenson ("Stephenson"), as sole plaintiff, for the benefit of The

---

NOTE. The printed Appendix in the Court of Appeals will be referred to as "App." followed by the page number.

Black Clawson Company ("Clawson") and its subsidiaries. The full caption appears in Appendix C, p. A8. On October 6, 1971, the District Court (per Charles H. Tenney, D. J.) denied a motion by the Trustees to substitute them as plaintiffs by virtue of Stephenson's demise on March 9, 1971, and dismissed the action *sua sponte* (Appendix C, p. A14). The Court of Appeals affirmed (Appendix B, p. A2).

Opinions Below

The opinion of the Court of Appeals, a copy of which is annexed as Appendix B, has not yet been officially reported. The opinion of the District Court is reported in 337 F. Supp. 591 (advance sheets of April 17, 1972). A copy thereof is annexed as Appendix C.

Jurisdiction

The judgment of the Court of Appeals was dated and entered June 26, 1972. Jurisdiction by the Supreme Court is invoked under 28 U.S.C. § 1254(1).

Statutes and Rules

The motion for substitution of plaintiffs was grounded on Rule 25(a) of the Federal Rules of Civil Procedure ("FRCP"), which deals with the substitution of parties based upon death. The rule provides:

"Rule 25. Substitution of Parties.

(a) Death.

(1) If a party dies and the claim is not thereby extinguished, the court may order substitution of the proper parties. The motion for substitution may be made by any parties or by the successors or representatives of the deceased party and, together with the

COPY BOU

notice of hearing, shall be served on the parties as provided in Rule 5 and upon persons not parties in the manner provided in Rule 4 for the service of a summons, and may be served in any judicial district. Unless the motion for substitution is made not later than 90 days after the death is suggested upon the record by service of a statement of the fact of death as provided herein for the service of the motion, the action shall be dismissed as to the deceased party."

Significantly, Rule 25(a) FRCP does *not* contain a requirement that an amended pleading must accompany a motion for substitution based on death.

Also relevant are Secs. 626(a) and 626(b) of the New York Business Corporation Law which went into effect on September 1, 1963 (*infra*, p. 9).

Questions Presented

1. Was the affirmance by the Court of Appeals of the judgment denying substitution of the Trustees-Petitioners as parties plaintiffs and dismissing the action, without even granting leave to Petitioners to file an amended complaint no less, reversible error in light of the following:

(a) The vesting of legal title in Petitioners to the Clawson stock on February 24, 1969; their eligibility to sue independently for the benefit of Clawson as to the wrongs committed by the fiduciaries-defendants-respondents after said date; and the right of Petitioners, as substituted plaintiffs, to complain of continuing wrongs right up to the date of trial by appropriate amendment in due course.

(b) Public policy to keep the machinery of justice in motion in stockholders' derivative actions.

(c) The absence of a "justifying reason" for sanctioning the summary dismissal of the action.

BOUND CLOSE IN CENTER

(d) The fact that Clawson, dominated by Landegger, has been and is in antagonistic hands; the fact that Clawson has been compelled by Landegger to conceal the existence of the action from Clawson's shareholders; and the fact that access to the stock list has been refused.

(e) The right of the Petitioners to become plaintiffs in the action although lacking complete diversity independently; and contravention by the Court, in effect, of the doctrine that once jurisdiction by diversity attaches, such jurisdiction may not be ousted by subsequent events.

Statement

Stephenson, the sole plaintiff in the action commenced by him on July 25, 1969 as noted, was a citizen of Virginia; no other party was a citizen of Virginia; and jurisdiction grounded on diversity of citizenship was clear. Clawson, for whose benefit the action was brought, is an Ohio corporation having its main offices at 200 Park Avenue, New York, N.Y. The defendants served in the action were Karl F. Landegger, Carl C. Landegger, George F. Landegger, Parsons & Whittemore, Inc. and Clawson. As is customary in a stockholder's action, the corporation for whose benefit such a suit is filed is sometimes referred to as a nominal defendant.

The trust agreement pertinent at bar (App. 13-37 incl.), as well as the Last Will and Testament of Stephenson (App. 38-43 incl.), were executed on the same day, to wit, February 24, 1969, some five months before the action was filed. Stephenson died on March 9, 1971, and his Will was probated in Virginia on March 22, 1971 (App. 44). The motion for substitution of plaintiffs was timely made by the Trustees and Executors. The within petition is made by the Trustees alone.

Defendant Karl F. Landegger ("Landegger") was the dominant personality in the affairs of Clawson, being the

COPY BOU

owner of a majority of Clawson's outstanding stock through several corporations whose stock was wholly-owned by him. Landegger exercised his power of control over Clawson since 1956 (App. 318, 322).

A. The Complaint

In essence, the amended complaint (App. 315-361 incl.) charged Landegger with self-dealing and the commission of other wrongs at the expense of Clawson and its subsidiaries. The challenged transactions were allegedly conceived by Landegger and consummated under his sponsorship and direction (App. 319). Landegger was assisted in conflict-of-interest transactions by his two sons, defendants Carl C. Landegger and George F. Landegger. Defendant Parsons & Whittemore, Inc., the top company in the Landegger hierarchy, whose outstanding stock is owned by Landegger, was one of the vehicles employed by him in committing the charged wrongs.

The self-dealing chargeable to Landegger involved millions of dollars in transactions between Clawson and its subsidiaries on one hand and certain corporations whose stock was wholly-owned by Landegger on the other, including many purchases and sales of equipment and the rendition of numerous services. In sum, certain corporations whose stock was wholly owned by Landegger underpaid for purchases made and services secured from Clawson and its subsidiaries, and overcharged for sales made and services rendered to Clawson and its subsidiaries. App. 318-321; 325-326; repeated in substance in other counts.

Apart from the Landegger-owned corporations specifically identified in the complaint as having engaged in transactions with Clawson and its subsidiaries, the complaint alleged that other Landegger-owned corporations also dealt with Clawson and its subsidiaries. It subsequently appeared from Landegger's answers to Plaintiff's Interrogatories, First Series, that a score of such addi-

BOUND CLOSE IN CENTER

tional corporations so traded (Document No. 37, pp. 7-12 incl.). In dollar volume and quantities, the conflict-of-interest transactions are unparalled in corporate annals.

The doctrine of fiduciary relationship was invoked by plaintiff, by virtue of which Landegger, as a director, officer and controlling stockholder of Clawson, as well as the principal architect of the self-dealing, had the burden of (a) overcoming the presumption of fraud that attached thereto, (b) establishing the fairness of the transactions to Clawson, and (c) negating unjust enrichment therein. *Pepper* v. *Litton*, 308 U. S. 296; *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 599; *Southern Pacific Company* v. *Bogert*, 250 U. S. 483, 487, 492; *Magruder* v. *Drury*, 235 U. S. 106, 119.

In addition to self-dealing, Landegger was also charged with depriving Clawson and its subsidiaries of corporate opportunities; misusing inside information as to Clawson to his unjust enrichment; paid excessive compensation for part-time services, etc. (App. 319, 320, 325).

The District Court opinion stated that the challenged transactions went back a quarter of a century (Appendix C, p. A9), and the Court of Appeals mentioned this aspect twice (Appendix B, pp. A5-6). The fact is, however, as reference to the complaint will readily establish, that the earliest wrongs challenged were in 1956, some thirteen years before the action was instituted. Hence the Court erred in stretching the thirteen-year period to "a quarter of a century", an unfounded irritant to the Court. As to wrongs committed more than six years prior to the commencement of suit, it was alleged that Landegger was equitably estopped to plead the statute of limitations, and the reasons for such bar set forth (App. 322-324). Pertinent excerpts on the question of equitable estoppel appear in Appendix D.

Continuing wrongs are involved at bar. In one category alone, to wit, sales by Clawson to Landegger-owned

COPY BOU

companies, the recent annual reports of Clawson show that the conflict-of-interest transactions on said phase amounted to $3,419,969 in 1969; $3,867,855 in 1970; $1,283,901 in 1971; and $1,459,761 in 1972, for an aggregate additional $10,036,486 (App. 103). In the normal course, an amendment to include continuing wrongs to the date of trial would be appropriate.

The original complaint was compacted into two counts (App. 159-170). The defendants-respondents moved for a more definite statement, granted by the District Court, with the result that a thirteen-count amended complaint was filed on or about May 21, 1970 (App. 315-361).

Prior to the commencement of the action, a freeze existed on information by Clawson to its stockholders concerning the self-dealing involved at bar (App. 395, 406-408). Access to the stock list was also refused, and shareholders of Clawson are unaware to this day of the Stephenson action to redress the wrongs resulting from conflict-of-interest transactions.

B. The Trust of February 24, 1969

Stephenson, the settlor of the trust, designated himself as the sole beneficiary during his lifetime, and named three Trustees, to wit, The Central Trust Company of Cincinnati, Ohio, and his two sons, Edward L. Stephenson and Garrick C. Stephenson. The two sons (petitioners herein) were named as principal beneficiaries upon his death (App. 13-24).

In creating the trust, Stephenson retained the unfettered right (a) to revoke the trust at any time; (b) to change its terms at any time; and (c) to withdraw property from the trust at any time (App. 15). He also retained record ownership of the Clawson stock, and such stock is still registered in his name on the books of Clawson (App. 53). The trust agreement authorized the Trustees to hold trust property for such period as they deemed best. Appendix B, p. A5; Appendix C, p. A10; App. 20.

BOUND CLOSE IN CENTER

C. Functions of a Stockholder's Derivative Action

There is an important distinction between a stockholder's derivative action and the ordinary plenary suit in determining the capacity of a plaintiff to sue. In the ordinary case, a plaintiff asserts a primary right and must be the real party in interest. In a derivative suit, the plaintiff is a mere instigator, the real party in interest being the corporation for whose benefit the action is brought. The derivative suit was an invention of equity to supply a remedy where those who control a corporation fail or refuse to seek redress for corporate wrongs.

Typical of textwriters' views and court pronouncements is *20 Carmody-Wait Cyclopedia of New York Practice*, 2d Ed., pp. 171-172, thus:

> "A shareholder's derivative action is an action brought by one or more shareholders of a corporation to remedy or prevent a wrong to the corporation in cases where the corporation, because it is controlled by the wrongdoers or for other reasons, fails and refuses to take appropriate action for its own protection. Such an action is equitable in nature. It is the only civil remedy that shareholders have for breach of fiduciary duty on the part of those entrusted with the management and discretion of their corporations."

And at p. 181:

> "Thus, the right to bring a derivative action, asserting the corporation's claims, arises from the claimed disability of the directors because of lack of independence or otherwise to do so, with the plaintiff stockholder being merely the instigator to place the corporation's rights and claims before the Court and not the individual rights of numerous stockholders as is the case in a representative action asserted by a limited agent acting for persons too numerous to present their individual rights separately."

COPY BOU

One of the earliest recorded decisions sustaining a stockholder's derivative action was *Dodge* v. *Woolsey*, 59 U.S. (18 How.) 331, rendered in 1855. A Federal court in Ohio, in a diversity case, upheld the right of a stockholder to sue derivatively to redress a corporate wrong, and the Supreme Court affirmed the holding. Subsequently, in *Hawes* v. *Oakland*, 104 U.S. 450, the Supreme Court observed (p. 457): "The case of *Dodge* v. *Woolsey*, decided in this court in 1855, is, however, the leading case on the subject in this country."

The various editions of *Pomeroy on Equity Jurisprudence* consistently emphasized that the chief function of a derivative suit was to set the machinery of justice in motion (e.g., 4 Pomeroy, 5th Ed. p. 269), repeated a few pages later thus (p. 278):

> "The stockholder is permitted to sue • • • *simply in order to set in motion the judicial machinery of the Court.*" (Emphasis in original).

D. Status to Sue

Since jurisdiction was based on diversity of citizenship, it becomes appropriate to consider briefly the law of New York on capacity to sue in a stockholder's derivative action. Applicable are Secs. 626(a) and 626(b) of the New York Business Corporation Law ("BCL"), in effect since September 1, 1963 (Book 6, McKinney's Consolidated Laws of New York).

Sec. 626(a) BCL provides:

> "An action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor, by a holder of shares or of voting trust certificates of the corporation or of a beneficial interest in such shares or certificates."

Sec. 626(b) BCL reads:

> "In any such action, it shall be made to appear that the plaintiff is such a holder at the time of bringing

BOUND CLOSE IN CENTER

> the action and that he was such a holder at the time of the transaction of which he complains, or that his shares or his interest therein devolved upon him by operation of law."

The term "holder" in the statute patently embraces a broader spectrum of eligible suitors than an "owner" variously described as "legal", "equitable", "registered" or "beneficial". Not only is a holder of shares eligible to sue; one who is the holder of a beneficial interest in such shares is likewise eligible. Parenthetically, the predecessor statute (Sec. 61 General Corporation Law) referred to an action brought by a "shareholder".

Even under the former General Corporation Law, the New York decisions confirmed a plaintiff's right to prosecute a stockholder's derivative action in a variety of situations, viz.:

(a) The beneficiary of a trust was held qualified to file such an action (*Braman* v. *Westaway*, 60 N.Y.S. 2d 190, 196; Sup. Ct. N.Y. Co. 1945).

(b) A pledgee of stock (held to secure a debt) was ruled qualified to sue (*New York Properties, Inc.* v. *Neidoff*, 10 Misc. 2d 439, 170 N.Y.S. 2d 693; Sup. Ct. N.Y. Co. 1957).

(c) The holder of a trust certificate was also qualified to sue (*Lewin* v. *New York Ambassador*, 61 N.Y.S. 2d 492, affd. 271 App. Div. 927 (1947), 67 N.Y.S. 2d 492).

The Federal courts in New York have supported stockholders' derivative actions in the following cases:

(d) By *former* stockholders, claiming fraud in exchanging their stock (*Willcox* v. *Harriman Securities Corporation*, 10 F. Supp. 532; SDNY 1933).

(e) By holders of convertible debentures (*Hoff* v. *Sprayregan*, 52 F.R.D. 243; SDNY 1971).

COPY BOU

(f) By warrant holders (*Entel* v. *Guilden*, 223 F. Supp. 129; SDNY 1963).

(g) A mere doubt on the question of eligibility to sue warranted denial of a motion to dismiss (*Heilbrunn* v. *Hanover Equities Corporation*, 259 F. Supp. 936, 939; SDNY 1966).

When stockholders' actions first came to notice in a trickle over a century ago, it was assumed that only registered (record) owners were eligible to sue. As the years went by the question arose whether so-called equitable or legal owners of stock were also so qualified. As the cases became more numerous, state after state permitted such actions. It was never a question whether an equitable or legal owner was the only qualified plaintiff; rather, the issue was invariably whether an equitable or legal holder *also* had the right to sue derivatively. In short, the earlier rigid requirement of record ownership was relaxed, the area of suability was enlarged, and equitable or legal owners were also accorded the same privilege of suit previously enjoyed only by record owners. *3B Moore's Federal Practice 1969*, § 23.1.17, pp. 23.1.152 *et seq.*, and cases cited therein.

Reasons for Granting the Writ

The defendants-respondents, fiduciaries of Clawson who engaged in self-dealing at Clawson's expense and hence became subject to the doctrine of fiduciary relationship (under which the presumption of fraud attached to the self-dealing), have emerged from the action with an unearned windfall—not only a dismissal of the action without leave to amend but also as immunity from suit by the Trustees-Petitioners in a Federal court—achieved not by something respondents did to earn such a reward but because a man died.

Examination of the rationale of the Court of Appeals in sanctioning the startling result produced by the District

BOUND CLOSE IN CENTER

Court's judgment discloses that it cannot stand analysis; the affirmance is unsupportable; and the least to which the Trustees-Petitioners were entitled was an opportunity to file an amended complaint restricted to wrongs committed by respondents since February 24, 1969, the date when the Trustees-Petitioners acquired legal title to the Clawson stock.

In sanctioning the summary dismissal of the action, the Court of Appeals failed to heed decisions of the Supreme Court on fundamental precepts.

Errors in Affirmance by the Court of Appeals Which Require Correction

1. It is undisputed that the Trustees-Petitioners acquired legal title to the Clawson stock on February 24, 1969. That being so, they became eligible to sue derivatively for Clawson's benefit as to wrongs committed by defendants after February 24, 1969.

Before Judge Tenney, defendants-respondents not only emphasized the unquestioned capacity of the Trustees to sue derivatively as to post-February 24, 1969 wrongs but also contended that the Trustees were the *only* eligible suitors (App. 70-71). Judge Tenney held, however, that Stephenson was independently eligible to sue as well by virtue of the galaxy of powers and rights preserved by him under the revocable trust (Appendix C, p. A12; App. 89-90).

2. In the Court of Appeals, the defendants-respondents emphasized a different approach, contending that although the Trustees were eligible to sue as to post-February 24, 1969 wrongs, such right ended automatically upon Stephenson's death because the trust purportedly terminated with the demise and the only function of the Trustees at that stage was to wind up the trust estate *instanter*. It being

COPY BOU

clear, however, that a trust does not terminate until after the trustee has finally accounted, conveyed the trust property to those entitled thereto, and been discharged (*Matter of Jones*, 306 N.Y. 197, 205; *Neary* v. *City Bank Farmers Trust Co.*, 260 App. Div. 791, 793; *Bolton* v. *Wernett*, 3 A.D. 2d 708; *Hausman* v. *Bourne*, 152 N.Y.S. 2d 667), the respondents' thrust on this phase was also blunted.

3. Despite rejection of respondents' main points as noted, the denial of substitution and dismissal of the complaint *sua sponte* was permitted to stand. In face, too, of the fact, as respondents themselves pointed out (App. 70-71), that the Trustees were not postured to sue independently in a Federal court for lack of diversity, thereby immunizing respondent from a Federal court suit by the Trustees.

It is well settled that original diversity rides with a case regardless of subsequent events. Once jurisdiction attaches by virtue of diversity of citizenship, the Court continues to have subject matter jurisdiction even if an applicant for substitution lacks diversity. Stephenson was undeniably a citizen of Virginia. Jurisdiction by diversity clearly existed at bar when the action was instituted. Therefor, the Trustees-Petitioners, although lacking independent diversity, were qualified as substituted plaintiffs. *Stewart* v. *Dunham*, 115 U. S. 61, 64; *Hardenbergh* v. *Ray*, 151 U. S. 112, 118; *Kirby* v. *American Soda Fountain Co.*, 194 U. S. 141, 145-146. The effect then of the denial of substitution and dismissal of the action is to bar access of the Trustees-Petitioners to the Federal courts and to compel them to start anew in a State court.

4. The Court of Appeals held that the question of dismissal of the action involved a discretionary matter, and that such discretion was not abused. We believe that the right of substitution at bar was mandatory but even assuming *arguendo* that the issue of substitution based on

BOUND CLOSE IN CENTER

death may be treated as a discretionary matter, there was in fact an arbitrary denial thereof and hence an abuse of the Court's discretion.

5. The opinion in the Court of Appeals states (Appendix B, p. A6):

> "Here there was no abuse. On the contrary, Judge Tenney candidly recognized that his conclusion to dismiss, rather than grant leave to amend, was a 'troublesome one'."

It is submitted that a fair reading of Judge Tenney's observation that his conclusion was a troublesome one signifies that there was doubt in his own mind as to the soundness of his decision.

Mindful that Rule 25(a) FRCP does *not* require that an amended pleading accompany a motion for substitution based on death, it may be appropriate to turn briefly to the line of demarcation to be drawn in determining whether the Court's discretion has been properly exercised or abused in a case where a proposed amended pleading is involved. This Court declared in 1962 in *Foman* v. *Davis*, 371 U. S. 178, 182:

> "Rule 15(a) declares that leave to amend 'shall be freely given when justice so requires'; this mandate is to be heeded. See generally, 3 Moore, Federal Practice (2d ed. 1948), ¶¶ 15.08, 15.10. If the underlying facts or circumstances relied upon by a plaintiff may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits. In the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of an allowance of the amendment, futility of amendment, etc.—the leave

COPY BO

sought should, as the rules require, be 'freely given.' Of course, the grant or denial of an opportunity to amend the grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules."

It is submitted that the reasons advanced at bar for the summary dismissal of the action simply cannot survive analysis, even if we applied the stricter test under Rule 15(a) FRCP in determining whether discretion was properly exercised or abused.

6. The Court of Appeals ruled that "in view of the relatively short period of time to be covered" by the wrongs which the Trustees could assert, it was satisfied that the institution of a new suit was the only guaranty against prosecution by the Trustees of pre-1969 wrongs (Appendix B, p. A6).

There is absolutely nothing in or outside the record to warrant a finding, even having any remote support, that the Trustees-Petitioners or their counsel would defy an order of any Court restricting the Petitioners from prosecuting wrongs committed prior to February 24, 1969. Nor is therefore any justification whatever for the implication that the District Court would have any difficulty enforcing a mandate that barred the Trustees or their counsel accordingly. Hence the opportunity to file an amended complaint covering the period since February 24, 1969 was the minimum relief to which the Trustees were entitled.

Moreover, three and one-half years have elapsed since February 24, 1969 which, with continuing wrongs actionable to the date of trial, projects a period completely at odds with the "relatively short period of time" referred to

BOUND CLOSE IN CENTER

by the Court of Appeals. And a lot of damage is, of course, possible even in a relatively short period of time.

7. The Court of Appeals stated it declined to rule whether the effective cut-off date for the assertion by the Trustees of claims for wrongs by Respondents should be February 24, 1969 or March 9, 1971 because the District Court purportedly had not made that decision (Appendix B, p. A7 fn.). Granted that Judge Tenney had used the phrase "or possibly after March 9, 1971" at one point, a correct interpretation of his holdings leads to the conclusion that Judge Tenney actually considered February 24, 1969 as the true cut-off date (Appendix C, pp. A13-14) since that was the date when the Trustees acquired legal title to the Clawson stock.

Judge Tenney declared, for example, that "the trustees were certainly proper parties plaintiff at the time the action was instituted" on July 25, 1969 (independently of Stephenson).

Another example: Judge Tenney stated that "it is not possible to determine from the complaint what portions thereof refer to matters actionable after February 24, 1969 and what portions relate to matters not so actionable."

A further example: Judge Tenney stated that "it would be necessary completely to restate the causes of action to limit them to events subsequent to February 24, 1969."

Moreover, if in fact no ruling had been made by the District Court as to the cut-off date, then a compelling reason exists independently for a reversal of the judgment.

Ironically, the observation by the Court of Appeals that it would leave the cut-off date question to the District Court if a new action were commenced, is hardly comforting to Petitioners, who lack diversity requisites to start a new Federal action.

COPY BOU

8. It is deemed appropriate, if not required, that something be said of the concern of the Court of Appeals about "wasteful litigation". Said the Court (Appendix B, p. A7):

> "The oral argument before us was particularly illuminating in persuading us that only in this way can we be sure that our mandate will be carried out without consuming endless time of the court, counsel and parties in wasteful litigation seeking to perpetuate claims that we hold, as did the district court below, have been extinguished by either the creation of the trust or the death of Stephenson."

As previously noted (*supra* p. 15), there is no basis whatever for any doubt that Petitioners would obey any mandate of any court. The irritation of the Court of Appeals apparently came from an answer by counsel for Petitioners on oral argument to a question, wherein he stated that, while Petitioners would be restricted to post-February 24, 1969 wrongs, candor required recognition of the fact that if a shareholder of Clawson with holding going back to 1956 (year of earliest wrongs alleged in the complaint) emerged and was willing to become a litigant, he could move to intervene; that Clawson, for whose benefit the action was instituted, would benefit from several phases of the twenty-month litigation prior to Stephenson's death if such intervention were permitted (See docket entries, App. 1-6).

The excerpt from the opinion about "wasteful litigation" is not only erroneous but also points-up a serious misconception by the Court of Appeals concerning the nature of a derivative action. Like any class action, the remedy was forged by our courts to enable any shareholder to join such an action upon a showing of proper credentials. As between a wrongdoing fiduciary with absolute control over a corporation's affairs and antagonistic to any "prying" by

BOUND CLOSE IN CENTER

shareholders on one hand and a shareholder seeking to enforce not a primary claim but one belonging to another (the wronged corporation), can there really be any doubt of the direction public policy points in allowing the sunlight to pierce the iron curtain and provide that day in court which has been denied at bar? Under the circumstances, was the Court justified in suggesting impliedly that such day in court was available elsewhere? The answers are "No".

It is crystal clear that so long as Petitioners proceeded alone in continuing the Stephenson action, there was and is no danger of "wasteful litigation" feared by the Court of Appeals. But if an old shareholder going back to 1956—not apathetic as most shareholders are—appeared and was willing to enter the fray, important litigation which took place in the Stephenson action would automatically become applicable, at least pertinent, to such intervenor's case. Referring to judicial economy, to compel a brand new action, in a State court no less, will itself produce the "wasteful litigation" which all courts deplore.

From what has been said, the reference by the Court of Appeals to "wasteful litigation" on a substitution motion based on death, is also unfair.

The suggestion by the Court of Appeals that creation of the trust or the death of Stephenson "extinguished" claims, was patently erroneous. Petitioners could be barred from asserting pre-1969 claims in Clawson's behalf, but the claims themselves (belonging to Clawson) were not extinguished; they could be asserted, for example, through any shareholder having stock going back to 1956, by intervening in the Stephenson action once the improper dismissal thereof is corrected.

The logjam of cases in urban courts and the consequent erosion in the administration of justice is a fact of life. But if prospective substituted plaintiffs are eligible to con-

tinue an action although lacking independent diversity under the doctrine previously mentioned, the result of a denial of the motion for substitution and dismissal of the complaint is to foist the litigation on a State court, which hardly contributes to a meaningful solution of the judicial housekeeping problem.

Finally, the critical question at bar is not one involving wasteful litigation but the right of petitioners to continue the Stephenson action as to wrongs committed after February 24, 1969.

CONCLUSION

The judgment of the Court of Appeals should not be permitted to stand. The wrongs to The Black Clawson Company, to the extent that redress therefor is or may become available in the Stephenson action, should be considered in said action rather than passed to another court. The petition ought to be granted.

Dated, New York, N. Y., September 15, 1972.

Respectfully submitted,

ABRAHAM K. WEBER,
Counsel for Petitioners.

APPENDIX A

Judgment of Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-sixth day of June one thousand nine hundred and seventy-two.

Present: HON. WILFRED FEINBERG
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS *Circuit Judges*

Samuel F. Stephenson, suing on behalf of himself and all other shareholders of the Black Clawson Company similarly situated, and in the name and right of The Black Clawson Company, and in the name and right of subsidiaries of the Black Clawson Company, to wit, Black Clawson International, Ltd. (England) Black Clawson (France), Black Clawson Kennedy, Ltd. (Canada) and Compania Federal de Fundicao (Brazil),

Plaintiffs-Appellees,

v.

Karl F. Landegger, Carl C. Landegger, George F. Landegger, Parsons & Whittemore, Inc., Parsons & Whittemore Lyddon Limited and Parsons & Whittemore (France) Parswhit Limited (Switzerland), Parsons & Whittemore Misa (Brazil), Ishikawajima Harima-Parsons & Whittemore (Japan), The Black Clawson Company, Black Clawson International Ltd. (England), Black Clawson Kennedy Ltd. (Canada), and Companhia Federal de Fundicao (Brazil),

Defendants,

Edward L. Stephenson, Garrick C. Stephenson, and the Central Company, as Trustee of Samuel F. Stephenson, Deceased; and Joseph W. Trundle, Edward L. Stephenson and Garrick C. Stephenson, as Executors of Samuel F. Stephenson,

Appellants,

LOUIS YAEGER,

Shareholder-Appellant.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the orders of Oct. 6, 1971 & Nov. 16, 1971 of said District Court be and they hereby are affirmed with costs to be taxed against the appellants.

It is further ordered, adjudged and decreed that the appeal from the order of December 9, 1971 be and it hereby is dismissed in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk.

APPENDIX B

Opinion of Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 651, 652, 653—September Term, 1971.

(Argued May 22, 1972 Decided June 26, 1972.)

Docket Nos. 71-2182, 72-1056, 72-1057

SAMUEL F. STEPHENSON,

Plaintiff,

and

EDWARD L. STEPHENSON, GARRICK C. STEPHENSON and THE CENTRAL TRUST COMPANY, as Trustees of Samuel F. Stephenson; JOSEPH W. TRUNDLE, EDWARD L. STEPHENSON and GARRICK C. STEPHENSON, as Executors of Samuel F. Stephenson; and LOUIS YAEGER,

Movants-Appellants,

v.

KARL F. LANDEGGER, CARL C. LANDEGGER, GEORGE F. LANDEGGER, PARSONS & WHITTEMORE, INC., and THE BLACK CLAWSON COMPANY,

Defendants-Appellees.

Before:

FEINBERG, MULLIGAN and TIMBERS,

Circuit Judges.

Appeals from orders entered in the Southern District of New York (1) by Charles H. Tenney, *District Judge*, denying a motion for substitution of certain executors and trustees as plaintiffs following death of named plaintiff in stockholders derivative action and dismissing the action; (2) by Judge Tenney reaffirming his earlier decision on reargument; and (3) by Sylvester J. Ryan, *District Judge*, denying a stockholder's motion to intervene in the dismissed action.

Affirmed as to orders (1) and (2); dismissed as to order (3).

ABRAHAM K. WEBER, New York, N.Y., *for Movants-Appellants.*

MAX FREUND, New York, N.Y. (Joel W. Sternman and Rosenman Colin Kaye Petschek Freund & Emil, New York, N.Y. on the brief), *for Defendants-Appellees.*

PER CURIAM:

Appellants, who are the executors and trustees of the estate of the named plaintiff in this stockholders derivative action, appeal from an order entered in the Southern District of New York, Charles H. Tenney, *District Judge*, denying their motion pursuant to Fed. R. Civ. P. 25 for substitution as parties plaintiff, and dismissing the action. They also appeal from Judge Tenney's order reaffirming his decision upon reargument. A stockholder, Louis Yaeger, who moved to intervene in the action after it had been dismissed, seeks to appeal from an order, Sylvester J. Ryan, *District Judge*, denying that motion. We affirm both of Judge Tenney's orders and dismiss the appeal from Judge Ryan's order.

Judge Tenney's opinion of October 6, 1971, 337 F.Supp. 591 (S.D.N.Y. 1971), sets forth a clear, comprehensive and

detailed statement of both the facts and the controlling law. We agree with his application of the law to the facts. It is sufficient for our purpose therefore merely to state the essential issues and the district court's rulings thereon, with which we agree.

The first essential issue involves the claims of the executors and trustees of the original named plaintiff (Stephenson) to be substituted as parties plaintiff following Stephenson's death on March 9, 1971. The action had been commenced on July 25, 1969 by Stephenson who for many years had owned 10,000 shares of the nominal defendant. The Black Clawson Company (Clawson). The amended complaint alleged derivative and double derivative claims on behalf of Clawson and six of its subsidiaries. It attacked a large number of transactions extending over a period of nearly 25 years. It was based upon alleged conflicts of interest involving chiefly defendant Karl F. Landegger who is said to have been the dominating personality in the business of Clawson and its subsidiaries.

On February 24, 1969, five months prior to commencement of the instant action, however, Stephenson had created a revocable trust and executed a will. His shares of Clawson stock constituted the corpus of the trust, having been delivered to the trustees at the time the trust was created. Stephenson retained the right to revoke the trust, to alter it and to withdraw the trust property. He was the sole income beneficiary.

Upon these facts, and for the reasons set forth in detail in Judge Tenney's opinion, he held that at the time of commencement of the action on July 25, 1969, although title to the Clawson stock was in the trustees, Stephenson was the holder of a beneficial interest in the stock, on the basis of which he had standing to institute the action. Such interest, while sufficient to institute the action, was terminated upon his death when the remainder interests became operative not by operation of law but by contract, i.e. under the provisions of the trust which became irrevocable upon

his death. Since no interest remained in Stephenson which passed to his executors, the latter acquired no right to be substituted as parties plaintiff in the pending action. The trustees or remaindermen, who derive their interests by contract and not by operation of law, may assert claims involving transactions only after February 24, 1969 (date of creation of the trust) or March 9, 1971 (date of death). We agree with Judge Tenney in each of these holdings.

The next essential issue is the propriety of Judge Tenney's dismissal of the action rather than granting leave to amend. This is a determination traditionally left to the sound discretion of the district judge. While the exercise of such discretion is reviewable, we will not interfere absent a clear showing of abuse. Here there was no abuse. On the contrary, Judge Tenney candidly recognized that his conclusion to dismiss, rather than to grant leave to amend, was a "troublesome one". Before reaching this conclusion, however, he pointed out that, with respect to the claims that the trustees or remaindermen are entitled to assert, "it is not possible to determine from the complaint what portions thereof refer to matters actionable after February 24, 1969 [or after March 9, 1971], and what portions relate to matters not so actionable." We agree.

Moreover, our independent examination of the entire record in this case leaves us with the firm conviction that Judge Tenney's ruling in this respect represents an eminently sound exercise of discretion. The amended complaint covers some 45 pages in the printed appendix. It sets forth 13 counts. It involves a multitude of transactions extending over a period of nearly a quarter of a century. In view of the relatively short period of time to be covered by claims the court has ruled the trustees or remaindermen may assert, we are satisfied that the only appropriate procedure, under the circumstances of this particular case, is to require in effect, if such claims are to be pursued, the commencement of a new action to sort out from the extinguished claims the causes of action

based on post-1969 or post-1971 transactions. The oral argument before us was particularly illuminating in persuading us that only in this way can we be sure that our mandate will be carried out without consuming endless time of the court, counsel and parties in wasteful litigation seeking to perpetuate claims that we hold, as did the district court below, have been extinguished by either the creation of the trust or the death of Stephenson.[1]

Finally, in view of the foregoing, it follows that the motion by the stockholder, Louis Yaeger, to intervene in the action after it had been dismissed, was properly denied by Judge Ryan's order of December 9, 1971. The appeal from Judge Ryan's order is dismissed.

In short we affirm Judge Tenney's orders of October 6, 1971 and November 16, 1971 on the well reasoned opinion of Judge Tenney below. 337 F.Supp. 591 (S.D.N.Y. 1971). We dismiss the appeal from Judge Ryan's order of December 9, 1971.

Affirmed in part; dismissed in part.

---

[1] Since the district court did not rule on whether the effective cut-off date should be February 24, 1969 (date of creation of the trust) or March 9, 1971 (date of death), we leave that determination to be made by the district court in the event a new action is commenced.

We also note for the record that the district court decision referred to by Judge Tenney on the issue of whether to dismiss or to grant leave to amend, *Milvy* v. *Adams*, 16 F.R.D. 105, 108 (S.D.N.Y. 1954), subsequently was reversed by this Court in a memorandum decision. *Milvy* v. *Adams*, 217 F.2d 647 (2 Cir. 1954). This has no bearing on our decision upholding the district court's exercise of discretion in the instant case.

APPENDIX C

Opinion of Judge Charles H. Tenney, U.S.D.J.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Copy #37937

69 CIVIL 3282

MEMORANDUM

SAMUEL F. STEPHENSON, suing on behalf of himself and all other shareholders of defendant The Black Clawson Company similarly situated, in the name and right of said defendant, and in the name and right of certain subsidiaries of said defendant, to wit, Black Clawson International Limited (England), Black Clawson (France), Black Clawson-Kennedy Limited (Canada), Companhia Federal de Fundicao (Brazil), Black Clawson, Inc. (formerly Black Clawson-Sumner, Inc.), and United Paper Machinery Corporation,

Plaintiff,

against

KARL F. LANDEGGER, CARL C. LANDEGGER, GEORGE F. LANDEGGER, PARSON & WHITTEMORE, INC., PARSONS & WHITTEMORE LYDDON LIMITED and PARSONS & WHITTEMORE (FRANCE),

Defendants,

and

THE BLACK CLAWSON COMPANY, BLACK CLAWSON INTERNATIONAL LIMITED (ENGLAND), BLACK CLAWSON (FRANCE), BLACK CLAWSON-KENNEDY LIMITED (CANADA), COMPANHIA FEDERAL DE FUNDICAO (BRAZIL), BLACK-CLAWSON, INC. (formerly BLACK-CLAWSON SUMNER, INC.), and UNITED PAPER MACHINERY CORPORATION,

Nominal Defendants.

TENNEY, J.

This is a motion pursuant to Rule 25 of the Fed. R. Civ. P. for substitution of certain executors and trustees as parties plaintiff by reason of the death of the named plaintiff in this stockholders' derivative suit. As will appear clear, some narrative by way of background is necessary.

This action was commenced by the filing of the complaint herein on July 25, 1969, the summons and complaint being served on July 29, 1969 only upon the defendants Karl F. Landegger, Carl C. Landegger, George F. Landegger and Parsons & Whittemore, Inc. (hereinafter referred to as "Parsons") and the nominal defendant, The Black Clawson Company (hereinafter referred to as "Clawson"). The present amended complaint grows out of an earlier motion to dismiss made by the individual defendants and Parsons, and asserts in thirteen (13) counts derivative and double derivative claims on behalf of the nominal defendant Clawson and six of its subsidiaries. The amended complaint attacks a multitude of transactions extending over nearly a quarter of a century and claimed to constitute conflicts of interest involving, for the most part, defendant Karl F. Landegger, the alleged dominating personality in the business and affairs of Clawson and its subsidiaries.

The plaintiff, Samuel F. Stephenson (hereinafter referred to as "Stephenson") was for many years the registered and beneficial owner of ten thousand (10,000) shares of Clawson common stock. However, it now appears that on February 24, 1969, five months before institution of the present action, Stephenson created a revocable trust and executed a will. It further appears that, although in both the original and amended verified complaints Stephenson alleged that he was the owner of the ten thousand (10,000) shares of Clawson stock, he had in fact delivered this stock to the trustees of the trust at the time of its execution on February 24, 1969, endorsed by him, and, further, had confirmed to the corporate trustee by letter dated March 12,

1969, that such stock constituted an asset of the trust. (Weber affid. of April 26, 1971, Answer E.)

Stephenson, the sole grantor, was also the sole income beneficiary. Upon his death, certain fixed or ascertainable amounts were to be distributed from the trust principal to certain of his past and present employees outright (or, in one instance, in trust) and to Yale University, and the balance of the principal was to be distributed to Stephenson's sons, Edward L. and Garrick C. Stephenson, or their estates. By amendment dated August 25, 1969, Stephenson also created a trust effective on his death, in a fixed amount, for the benefit of his mother during her lifetime with the remainder passing to his brother and sister or the survivor of them. Also by amendment dated July 25, 1970, Stephenson provided for the disposition on his death of certain specified securities to his brother and sister. Stephenson died on March 9, 1971.

Among the rights which Stephenson reserved to himself during his lifetime was the right to revoke or, from time to time, to modify, amend or alter its terms and provisions without the consent of the trustees, to withdraw property from the trust on ten (10) days' notice to the trustees, to approve investments, and to add property to the trust estate. Named as trustees were Stephenson's sons, Edward L. Stephenson, a Virginia resident, and Garrick C. Stephenson, a New York resident, and The Central Trust Company, organized and having its principal place of business in Cincinnati, Ohio.

Defendants contend that plaintiff Stephenson, having transferred his Clawson stock to the trust in February 1969, was not thereafter a shareholder of Clawson and therefore could not properly commence this action on July 25, 1969; that an action such as the instant one could have been brought only by the trustees, but in such a case diversity jurisdiction would be lacking; that assuming Stephenson had standing as a beneficiary, he could not have

brought suit unless all the other beneficiaries joined with him, in which case also diversity jurisdiction would be lacking; and, finally, even assuming Stephenson had the standing to institute this action, his executors and trustees have no right to be substituted in his place.

The first question to be determined is the standing of plaintiff Stephenson to institute this action on July 25, 1969. Since it is alleged that Clawson is a foreign (Ohio) corporation doing business in New York in derivative non-federal action, the law of New York would appear to be applicable. *Drachman* v. *Harvey,* No. 35077 at 4389-90, n.9; 4391 n.11 (2d Cir., decided July 21, 1971); Federal Rules of Civil Procedure Rule 17(b); N. Y. Business Corp. Law §§ 626 and 1319(a)(2) (McKinney 1963). Furthermore, it would appear that New York "has a more significant relationship to the occurrence and the parties" than does Ohio. *Restatement (Second) of Conflict of Laws,* § 302(2). Under New York law, a shareholders' derivative action may be brought "in the right of a . . . foreign corporation . . . by a holder of shares . . . of the corporation or of a beneficial interest in such shares. . . ." N. Y. Business Corp. Law § 626(a) (McKinney 1963). In any such action it must "appear that the plaintiff is such a holder at the time of bringing the action and that he was such a holder at the time of the transaction of which he complains, or that his shares or his interest therein devolved upon him by operation of law." § 626(b). Although in the instant case plaintiff's shares remained registered in his name on the books of Clawson, since plaintiff delivered the certificates to the trustees endorsed by him title was in the trustees subject to the terms of the trust, and plaintiff was no longer a holder of such shares. *McNeil* v. *Tenth National Bank,* 46 N.Y. 325 (1871); *Union Bank* v. *United States Exchange Bank,* 143 App. Div. 128, 127 N.Y.S. 661 (1911); *In re Friedman,* 184 Misc. 639, 54 N.Y.S.2d 45 (Sup. Ct.), *modified,* 269 App. Div. 834, 56 N.Y.S.2d 516 (1945). The question remaining is whether

plaintiff was the holder of a beneficial interest in such shares. I conclude that he was. *Braman* v. *Westaway*, 60 N.Y.S.2d 190, 196 (Sup. Ct. 1945), *modified*, 59 N.Y.S.2d 509 (Sup. Ct. 1946), and cases cited; *Marco* v. *Dulles*, 177 F. Supp. 533, 551 (S.D.N.Y. 1959).

In support of their contention that this action could only have been brought by the trustees or, if the trustees failed to act, by all the beneficiaries rather than by plaintiff Stephenson, in either of which events diversity jurisdiction would be lacking, defendants rely on *Matthies* v. *Seymour Mfg. Co.*, 270 F.2d 365 (2d Cir.) *petition for consideration en banc denied*, 271 F.2d 740 (2d Cir. 1959), *cert. denied*, 361 U. S. 962 (1960). However, assuming its continued vitality, *Matthies* is clearly distinguishable from the present case. Various and diverse interests, vested and contingent, were created under the testamentary trusts involved therein. The trustees having declined to sue (in which event the beneficiaries would have been concluded since the trustees would have represented their interests), the Court held that all the beneficiaries would have to be joined in a suit by one beneficiary in order that all might be concluded. In the instant action, the settlor is the sole income beneficiary during his lifetime and has reserved an unrestricted power to revoke the trust until his death, at which time the remainder and secondary trust provisions take effect. Accordingly, the acts of the settlor during his lifetime are binding on and conclude the other beneficiaries. *City Bank Farmers Trust Co.* v. *Cannon*, 291 N. Y. 125, 133, 51 N.E.2d 674 (1943). Thus, it seems clear that *Matthies* is no bar to Stephenson's right to institute this action at least as the "holder of a beneficial interest" in the shares.

However, this does not end the matter, for Stephenson has died and on his death the remainder interests, in fee or in trust, became operative not by operation of law but by contract, *i.e.*, under the provisions of the trust, and no interest remained in Stephenson which passed to his executors

Myer v. *Myer*, 271 App. Div. 465, 66 N.Y.S.2d 83 (1946), *aff'd*, 296 N.Y. 979, 73 N.E.2d 562 (1947); *In re Lachlan's Trust*, 24 Misc.2d 323, 193 N.Y.S.2d 408, 412-13 (Sup. Ct. 1959). Nor does *Salter* v. *Columbia Concerts, Inc.*, 191 Misc. 479, 77 N.Y.S.2d 703 (Sup. Ct. 1948), involving property passing by will, compel the conclusion that the remainder interests herein passed by operation of law. The results which distinguish the creation of a trust and the making of a will are marked and clear. *Van Cott* v. *Prentice*, 104 N.Y. 45, 52, 10 N.E. 257 (1887); *Robb* v. *Washington and Jefferson College*, 185 N. Y. 485, 493, 78 N.E. 359 (1906); *Pinckney* v. *City Bank Farmers Trust Co.*, 249 App. Div. 375, 292 N.Y.S. 835 (1937). While Stephenson may have had a sufficient interest to institute the action, the right to continue the action terminated when he effectively disposed of the stock other than by operation of law, *i.e.*, by the trust contract which became irrevocable on his death. *Gresov* v. *Shattuck Denn Mining Corp.*, 40 Misc.2d 569, 243 N.Y.S. 2d 760, 763 (Sup. Ct. 1963). Accordingly, it is held that Stephenson's executors acquire no right to substitution in his place by operation of law or otherwise, and the trustees and/or the remaindermen take by contract and not by operation of law. *Myer* v. *Myer*, *supra*.

The conclusion that the trustees and/or the remaindermen derive their interests by contract and not by operation of law compels the further conclusion that the only action which they may properly bring is one involving transactions after February 24, 1969, Federal Rules of Civil Procedure, Rule 23.1(1); N. Y. Business Corp. Law § 626(b) (McKinney 1963) or possibly after March 9, 1971, the date of death of plaintiff. While the trustees and/or remaindermen may be entitled to substitution (indeed, the trustees were certainly proper parties plaintiff at the time the action was instituted), it is not possible to determine from the complaint what portions thereof refer to matters actionable after February 24, 1969, and what portions relate to matters not so actionable. In order to comply with Rule 23.1(1)

of the Federal Rules of Civil Procedure, it would be necessary completely to restate the causes of action to limit them to events subsequent to February 24, 1969. *Milvy* v. *Adams*, 16 F.R.D. 105, 108 (S.D.N.Y. 1954). Although we are dealing with a derivative suit enuring to the benefit of the corporation so that the suit is not necessarily extinguished by the loss of status by the instigating stockholder, *Koster* v. *Stendig*, 190 Misc. 861, 76 N.Y.S.2d 284, 286 (Sup. Ct. 1947), the corporation herein is a nominal defendant in actual opposition to the suit and there is no motion presently before the Court for leave to intervene by a stockholder of Clawson who has the requisite standing to intervene on the basis of the present complaint. *Pikor* v. *Cinerama Productions Corp.*, 25 F.R.D. 92, 95 (S.D.N.Y. 1960). Although the conclusion reached herein is a troublesome one, the Court is constrained to deny plaintiff's motion for substitution and *sua sponte* to dismiss the complaint herein.

So ordered.

Dated: New York, New York,
October 6, 1971.

CHARLES H. TENNEY
U.S.D.J.

APPENDIX D

Excerpts from amended complaint verified May 18, 1970 and filed May 21, 1970.

20. During an earlier period, to wit, from January 1956 to July 25, 1963, there were other transactions between Clawson and Parsons exceeding several million dollars in the aggregate, including (a) sales of machinery and equipment by Clawson to Parsons, and (b) purchases by Clawson from Parsons. As to the sales of machinery and equipment by Clawson to Parsons, the articles in question were re-sold by Parsons to others at substantial profits to Parsons. The transactions aforesaid were engineered by defendant Karl F. Landegger and consummated under his sponsorship and direction.

21. In the transactions between Clawson and Parsons referred to in paragraph "20" hereof, the defendant Karl F. Landegger occupied the status of a fiduciary to Clawson and its shareholders, particularly to minority stockholders. All of said transactions are challenged by plaintiff as to their fairness and purported benefits to Clawson. Plaintiff invokes the doctrine of fiduciary relationship to said transactions, which rendered them presumptively fraudulent and imposed the burden upon the fiduciary defendant Karl F. Landegger (a) to establish the fairness of each such transaction to Clawson; (b) to establish that each transaction was beneficial and not detrimental to Clawson; (c) to establish that Clawson was not deprived of corporate opportunities therein; and (d) to establish that neither Karl F. Landegger nor Parsons was unjustly enriched at the expense and to the detriment of Clawson by virtue thereof.

22. With respect to sales of machinery and equipment by Clawson to Parsons alleged in paragraph "20" hereof,

said transactions were also subject to and are challenged under the doctrine of misuse of inside information by fiduciaries, in that defendant Karl F. Landegger utilized inside information for Parsons' (and hence his own) benefit, and also deprived Clawson of opportunities to earn substantial profits for itself.

23. The result of the transactions alleged in paragraph "20" hereof has been that defendants Karl F. Landegger and Parsons profited at the expense of Clawson in violation of the two doctrines aforesaid; that Clawson sustained substantial damages and losses of profitable corporate opportunities by virtue of the breaches of fiduciary duties by defendant Karl F. Landegger, in which Parsons collaborated; and that defendants Karl F. Landegger and Parsons were unjustly enriched thereby.

24. The statute of limitations has been tolled as to the transactions alleged in paragraph "20" hereof and the allegations in paragraphs "21", "22" and "23" pertaining thereto under the doctrine of equitable estoppel applicable to the wrongs herein of defendant Karl F. Landegger, in that:

(a) The control over Clawson and its subsidiaries held and exercised by defendant Karl F. Landegger since 1956 at least, has been absolute. At no time since 1956 at least, to the present, has any person served as a director of Clawson and its subsidiaries who was not subservient to the wishes and desires of defendant Karl F. Landegger, or who discharged his fiduciary duties as a director of Clawson or its subsidiaries by the exercise of judgment independent of the wishes and desires of defendant Karl F. Landegger. At no time since 1956 at least to the present has any director of Clawson or its subsidiaries questioned or challenged the conflict-of-interest elements which attached to the transactions herein alleged, and such noninterference, indifference, and disinterest was in obedience to the policy of subservience aforesaid.

(b) The nature, scope, and extent of the transactions alleged therein were not disclosed to and were concealed from the stockholders of Clawson, and the only persons having such knowledge were completely subservient to defendant Karl F. Landegger's policy of concealment thereof from Clawson's minority stockholders.

(c) Final terms as to prices, among other things, in the Clawson-Parsons transactions alleged therein were not determined through arms-length bargaining between said corporations but determined and dictated by defendant Karl F. Landegger after predetermination by him of the prospective charges to be made by Parsons to others for machinery and equipment to be obtained by Parsons from Clawson; that said predetermination of charges to others by Parsons was not disclosed by defendant Karl F. Landegger to Clawson.

(d) The concealments from stockholders and the absolute control exercised by defendant Karl F. Landegger over the business and affairs of Clawson, as well as the subservience of directors and officers of Clawson to the wishes and desires of defendant Karl F. Landegger, left no director or officer of Clawson who would challenge any conflict-of-interest transactions relating to or affecting defendant Karl F. Landegger, directly or indirectly, and there were no informed minority stockholders of Clawson free of the domination of defendant Karl F. Landegger who had knowledge of the transactions complained of herein.